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Research proposal: Globalization of financial markets, Hungary and Slovenia

From the several debates surrounding globalization of financial markets this research proposal is part of the one which is formulated around the issue of how global changes translate into local changes.

The concept of globalization:
This research tries to overcome the deterministic dichotomy between national and international, local and global and maintains, that globalization – following the logic of Saskia Sassen and Johnatan Perraton – materializes in national territories through national institutional arrangements. Therefore, the impact of globalization of financial markets should not be counted as an exogenous effect on the domestic settings. Consequently, the research will not take for granted that because a transaction takes place in a national territory and in a national institutional setting, it is ipso facto national. (e.g. central banks, though national institutions, can easily become key institutions in implementing the new rules of global economy such as some of the aspects of IMF conditionality) Rather, globalization will be seen not as an externally generated process, but conceptualized - following the account of Guillén – as a process which creates mutual awareness of the actors of each other and of changes. In other words, globalization is understood as a result of purposive human agency both working within the parameters of existing institutions and attempting to modify these institutions and to create new ones so that they fit more properly into the logic of the globally working processes and their accounts.

Puzzle: Globalization of international financial markets is understood by a large number of researchers (Cerny 1998, Verdier 2000, McNamara 1998, Keohane and Milner 1996, Mittelman 1997) as producing common structural changes in national financial markets. Hungary and Slovenia should be no exceptions. Yet, in the course of transition these two countries followed significantly different developments in the arrangement of their financial markets and arrived at different outcomes with regards to state involvement in the financial sector. An obvious explanation for the important differences could be substantially varying initial conditions. However, the initial conditions in terms of market liberalization and ownership structure showed similar patterns in both countries, i.e. both states started with a financial market more open than other countries in Central and Eastern Europe. Hence, in addition to the supposedly homogenous constraints stemming from the development of international financial markets, in the case of these two countries we can observe financial markets with relatively similar initial patterns. Therefore, given the similarities in initial conditions combined with similar international constraints it is puzzling that after a decade the outcomes have been remarkably dissimilar and Slovenia started to engage in rearranging its financial market only in the year 2001.

Hence, the *research question* of the proposal emerges: why after a decade, the observed outcomes of state involvement in the two countries' financial markets differ?

(*dependent variable: privatization and modernization policies of the banking sectors of the two states*)

Why is this question interesting?

1) Financial market development is on the forefront of economists‘ analyses, yet political scientists or scholars of international political economy, for that matter, pay unjustifiably little attention to the contemporary progress in this filed. In an insightful study, John Zysman (Zysman 1983) was among the first scholars of politics who demonstrated that political analysis of financial markets has major resources to contribute to our knowledge with regards the way in which financial markets develop. His major tenets were firstly, that the financial market is a most important segment of a national economy, whose major role is to channel savings to investments. Secondly, it is the structure of the domestic financial market which limits the room for maneuver of the domestic and foreign companies as well as that of the governments in the national economy. Finally, it is the structure of the domestic financial market, which determines how the external disturbances are translated into domestic disturbances. In other words, it is important to look at financial markets, since the domestic financial markets condition how international changes influence the local operation of firms and the coordinating capabilities of the state.

2) Moreover, there is a need to provide a deep understanding of state and financial communities behavior of Central and Eastern European countries, which then further allows policy maker of the region and outside it to draw lesson for the formulation of future policies. Further, this research also contributes to the existing literature in two important ways. First, it promises to fill a gap between transition literature and globalization literature. There is a missing link between the two fields of interest, because on the one hand explanations for global changes mostly gave insights to the various forms of adaptations and responses of the western state and few describe the role of the transitory states. On the other hand, scholars who were interested in transition paid little attention to the globalizing processes. Second, this research contributes to our understanding of globalization of financial markets by applying a non-individualist approach instead of the mainstream instrumental (cost-benefit) explanation for capital inflows and capital outflow. Hence, the research might help to clarify concepts and methods regarding state behavior in international finance.

How to answer the question?

It needs to be clarified at the very outset, what the proposed research seeks precisely to explain. As it becomes clear from the puzzle and the research question, the dependent variable here is the modernization policies of the state with regard to the banking sector. In order to get to an analytical framework it is important firstly, to analyze which state institution (Central Bank, Ministry of Finance, state owned banks, etc.) had more power in the initiation of institutional arrangement of the two countries’ banking sectors. In the case of Hungary, Central Bank appears to have a major power whereas in Slovenia, state owned banks seem to be the most important. This factor is interesting because the development of the financial markets was prone to produce shifts in the configuration of power among the various state institutions.

Another interesting characteristic of the banking sectors is the schemes of the allocation of resources. In other words, the favored credit policies in a particular banking systems seems to serve a ground for explanation. The credit policies followed by banks have a long-term impact on the development of the different sectors of the economy, because they determine which investors and borrowers under what conditions have access to capital. Therefore, it is important to investigate the state policies aiming to reform the two countries’ banking sectors, with regards to their redistributive consequences. Finally, the research would try to elaborate on the links between the above market characteristics and scope of state policy making. Concentrating on banking sector institutions the study would infer which policies are possible and which have serious limitations. (bracketing)

Finally, I speculate that the operation of state institutions on the local level of financial markets is conditioned by changes in the international financial market. Hence, the interplay between international financial markets and internal institutions may also explain a part of the particular policy choices.

Remarks on the mechanisms:
The method of explanation then would follow the logic of a dynamic model, tracing the effects (constraints, incentives) of the effect of globalization of the domestic institutions on the state policies with regards to banking sector restructuring. This method of process tracing is widely accepted within the institutionalist approach. Moreover, the institutionalist (comparativist) explanations provide a wide range of testable hypothesis for the causes of different outcomes. (Kurzer 1993, Crouch and Streeck 1997, Maxfield 1997, Pérez 1998, Loriaux 1997) Precisely which track of explanations this research will follow will be specified in a later stage.

Case selection
Hungary and Slovenia were chosen on the basis of the observation that among the transition countries of Central and Eastern Europe these two countries are the most peculiar with regard to state involvement in financial markets. It means that in comparison to other possible country-pairs these two countries are at the same the relatively most similar in initial conditions in terms of financial market institutions (including the relative weight of Hungary's debt) and most different in outcomes. Three points are important here to make the above claim clear. First, in the literature on the transition economies, there is a strong consensus that the post-Soviet republics, on the one hand, and other post-socialist countries on the other, experienced significantly different initial conditions of the economy as well as different influence from the international setting. This implies that the difference in outcomes between the two blocks of countries is largely influenced by initial conditions, hence it is not so puzzling (e.g. Estonia-Hungary). Second, among the non-post–Soviet Central and Eastern European countries the following four are the most advanced countries in terms of economic and political transition as well as closest to EU integration: Poland, Czech Republic, Hungary, and Slovenia. It means that in order to reduce the number of the bias among explanatory variables, this research design had to select either out of the latter four countries or from the rest of the non-post-Soviet block. Since in this research proposal focuses on the interplay of the international and national factors and since the success stories of post-communist countries were exposed to more similar international influence (e.g. EU trade relations, early EU association, geographical location, etc.) the selection was made from the last four countries. Finally, in order to provide evidence and hence contribute to the debate on the effects of globalization of financial markets, it was important that out of these countries the research concentrates on those having the most contrasting features in financial markets.

The comparison of the two countries is interesting because it helps to delineate a generalizable argument as for the way in which changes in the international market structure shape state involvement in transition countries.